Explaining Cross-National Variations in the Prevalence and Character of Undeclared Employment in the European Union

Colin C. Williams
Sheffield University Management School, University of Sheffield, Conduit Road, S10 1FL Sheffield, United Kingdom, c.c.williams@sheffield.ac.uk

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PART II
ARTICLES

Colin C. WILLIAMS*

EXPLAINING CROSS-NATIONAL VARIATIONS
IN THE PREVALENCE AND CHARACTER OF UNDECLARED
EMPLOYMENT IN THE EUROPEAN UNION

Abstract. The aim of this article is to evaluate the competing theories that variously explain the greater prevalence of undeclared employment in some countries either as: a legacy of under-development; a result of the voluntary exit from declared employment due to the high taxes, state corruption and burdensome regulations and controls, or a product of a lack of state intervention in work and welfare which leads to the exclusion of workers from the declared economy and state welfare provision. Analyzing the cross-national variations in the prevalence of, and reasons for, undeclared employment across the European Union using evidence from a 2007 Eurobarometer survey, the finding is that undeclared employment is less prevalent and more of the voluntary variety in wealthier, less corrupt and more equal societies possessing higher levels of social protection and redistribution via social transfers. The theoretical and policy implications are then discussed.

Key words: informal sector, undeclared work, shadow economy, neo-liberalism, European Union.

1. INTRODUCTION

Since the turn of the millennium in Europe, there has been growing recognition that undeclared employment not only lowers work quality standards and creates risks for the health and safety of workers, but also acts as a brake on economic growth, puts at greater risk the financial sustainability of social protection systems and undermines the legitimate business environment through unfair competition

* Colin C. WILLIAMS, Sheffield University Management School, University of Sheffield, Conduit Road, S10 1FL Sheffield, United Kingdom, e-mail: C.C.Williams@sheffield.ac.uk
Colin C. Williams

(European Commission, 1998, 2003, 2007; Gallin, 2001; Williams and Renooy, 2013). The result is that greater attention has started to be paid to not only understanding the prevalence of, and reasons for, undeclared employment (GHK and Fondazione Brodolini, 2009; Renooy et al., 2004; TNS Infratest et al., 2007) but also what needs to be done to tackle the undeclared economy (Dekker et al., 2010; European Commission, 1998, 2007a, b, 2012a, b; European Parliament, 2008; Williams and Renooy, 2013). The intention of this article is to further contribute to this emergent understanding by evaluating critically three competing theories that explain the cross-national variations in undeclared employment in Europe in different ways.

To achieve this, the first section will briefly review the competing theories that variously explain the cross-national variations in the prevalence of, and reasons for, undeclared employment either as: a legacy of under-development (modernisation perspective); an outcome of voluntary exit from declared employment due to the high taxes, state corruption and burdensome regulations and controls (neo-liberal perspective), or a result of the lack of state intervention in labour markets and social protection which leads to the exclusion of workers from the declared economy and state welfare provision (political economy perspective). To evaluate critically the validity of these explanations, the second section will then report the methodology of the 2007 Eurobarometer survey here used to analyze the cross-national variations in the prevalence of, and reasons for, undeclared employment in the EU-27 and the validity of the competing perspectives. In the third section, the descriptive results will be reported regarding the cross-national variations in the prevalence of, and reason for, undeclared employment followed in the fourth section by a critical evaluation of the competing theories that have sought to explain these cross-national variations. Finding a strong correlation between cross-national variations in the prevalence of, and reasons for, undeclared employment across the EU-27 and cross-national variations in some of the societal characteristics identified by each of the theoretical explanations but not others, the fifth and final section will then call for the adoption of a new ‘neo-modernisation’ perspective and tentatively discuss the policy implications of these findings.

In this paper, undeclared employment is defined as ‘productive activities that are lawful as regards their nature, but are not declared to the public authorities, taking into account the differences in the regulatory systems between Member States’ (European Commission, 2007a, p. 1). As such, these are activities not declared to the public authorities when they should be for tax, social security and labour law purposes, but they are legal in all other respects (European Commission 1998, 2007a, b; OECD 2012; Renooy et al., 2004; Pfau-Effinger, 2009; Sepulveda and Syrett, 2007; Williams, 2006). If the goods and services involved are illegal or the work is unpaid, these activities are not delineated as undeclared employment but rather, part of the ‘criminal’ or ‘unpaid’ economies respectively. There
Explaining Cross-National Variations in the Prevalence of Undeclared Employment

are of course blurred edges, such as when gifts or in-kind labour are exchanged in lieu of money (White, 2009). Here, nevertheless, it is only deemed undeclared employment if money changes hands between the employer/purchaser and employee/supplier.

Conventionally, only fully undeclared employment has been analyzed. This is where the employee is not in a declared employment relationship. Recently, however, especially in East-Central Europe, it has been recognized that declared employers sometimes pay a declared employee both a declared salary and an additional undeclared (‘envelope’) wage (Karpuskiene, 2007; Neef, 2002; Sedleńieks, 2003; Williams, 2007, 2009, 2010; Williams and Padmore, 2013; Woolfson, 2007). In this article therefore, not only wholly undeclared employment but also under-declared employment is considered.

2. EXPLAINING CROSS-NATIONAL VARIATIONS IN UNDECLARED EMPLOYMENT

It is now widely recognized that across the globe, undeclared employment is extensive and even growing relative to declared employment (Buehn and Schneider, 2012; ILO, 2011; Jütting and Laiglesia, 2009; Mehrotra and Biggeri, 2007; OECD 2012; Schneider, 2008, 2011). However, it is also recognized that undeclared employment is unevenly distributed across different global regions (ILO, 2011) and cross-nationally (Buehn and Schneider, 2012; Feld and Schneider, 2010; ILO, 2002; Schneider, 2011). Reviewing how this has been explained, three rival theorisations can be identified. Each is here briefly reviewed in turn.

2.1. Modernisation Perspective

Over the course of the 20th century, a common belief was that as economies developed, undeclared employment, which was viewed as a leftover from a pre-modern mode of production, would recede and declared employment would become ever more hegemonic as countries modernized. Undeclared employment was thus depicted as concentrated in less modern economies and a signal of their ‘backwardness’ and ‘under-development’ (Geertz, 1963; Lewis, 1959). It became increasingly apparent however, that not all ‘under-developed’ economies were indeed making this transition towards a modern developed economy, as evidenced by the widespread persistence and even growth of undeclared employment which in many economies was found to be growing relative to declared employment (Buehn and Schneider, 2012; Dibben and Williams, 2012; Feld and Schneider,
The outcome was that it began to be realized that if the cross-national variations in undeclared employment were going to be understood, then new explanations would be required.

2.2. Neo-liberal Perspective

For neo-liberal commentators, undeclared employment is extensive because those engaged are making a rational economic decision to voluntarily exit the declared economy in order to avoid the high taxes, corruption in the state system and the burdensome regulations that increase the cost, time and effort associated with declared employment (e.g., Becker, 2004; De Soto, 1989, 2001; London and Hart, 2004; Nwabuzor, 2005; Sauvy, 1984; Small Business Council, 2004). Undeclared employment from this neo-liberal perspective, in consequence, is seen as more prevalent in nations with higher taxes and public sector corruption and greater state interference in work and welfare provision. The consequent solution is to reduce taxes, corruption and state intervention.

2.3. Political Economy Perspective

For many political economy commentators, in contrast to neo-liberals, undeclared employment is not the result of too much but too little state intervention in work and welfare. From this perspective, undeclared employment is conceptualized as a tool used in the new downsizing, sub-contracting and outsourcing arrangements emerging under de-regulated global capitalism since this form of work provides businesses with a production channel to attain flexible production, profit and cost reduction (Amin et al., 2002; Castells and Portes, 1989; Davis, 2006; Gallin, 2001; Hudson, 2005; Sassen, 1996; Slavnic, 2010). The outcome is that the full-employment and comprehensive formal welfare state that characterized the Fordist and socialist era is disappearing (Amin et al., 2002; Fernandez-Kelly, 2006; Hudson, 2005). In its place, a new post-Fordist and post-socialist regime of deregulation, liberalisation and privatisation is emerging (Castells and Portes, 1989; Meagher, 2010; Sassen, 1996). Undeclared employment is thus conducted out of necessity as a last resort in the absence of other means of livelihood (Ahmad, 2008; Castells and Portes, 1989; Sassen, 1996) and is more prevalent in economies in which there is less state intervention in work and welfare provision in the form of active labour market policies, social protection and social transfers. The remedy to reduce undeclared employment is therefore to pursue greater intervention in work and welfare arrangements (Davis, 2006; Gallin, 2001; Slavnic, 2010).
Until now, few if any studies have evaluated the validity of these competing explanations. To do so, attention now turns to an analysis of the cross-national variations in undeclared employment across the EU-27 and whether this is correlated with the various societal characteristics used by each theorisation.

3. METHODOLOGY: EXAMINING UNDECLARED EMPLOYMENT IN THE EU-27

Here, the only extensive cross-national survey currently available is used, namely Special Eurobarometer No. 284 (Undeclared Work in the European Union), conducted as part of wave 67.3 of the 2007 Eurobarometer survey (European Commission, 2007a). Similar to other Eurobarometer surveys, this used a multi-stage random (probability) sampling method in every member state. To examine the prevalence of, and reasons for, undeclared employment, participants were firstly interviewed for their opinions and attitudes regarding undeclared employment and having established a rapport, questions were then asked about their acquisition of goods and/or services on an undeclared basis over the year prior to the survey. Following this, those participants in formal employment were questioned about whether they had received envelope wage payments from their employer, and if they were happy with this or would have preferred to have had their full gross salary declared. And finally, their participation in wholly undeclared employment was investigated, including their reasons for participating in this work in terms whether it was due to exit and/or exclusion rationales.

To analyze the validity of the various explanations, official data sources have been employed wherever feasible to examine statistical indicators of the various societal characteristics each perspective asserts are the key drivers underpinning engagement in undeclared employment, such as the level of GDP per capita, taxation levels, levels of social protection and state redistribution (European Commission, 2011, Eurostat, 2007, 2010, 2013a, b, c). The only indicators derived from unofficial data sources are the level of public sector corruption, derived from Transparency International’s (2013) corruption perceptions index for 2007 and evidence on the quality of state bureaucracy derived from the International Country Risk Guide (ICRG, 2013).

To explore the relationship between the cross-national variations in the prevalence of, and reasons for, undeclared employment and the range of societal characteristics these perspectives delineate as drivers, and given the small sample size of 27 member states and lack of necessary controls to include in a multivariate regression analysis, it is only possible here to conduct bivariate regression analyzes of the relationship between undeclared employment and these different societal
characteristics that each perspective denotes as influential. As will be shown, nevertheless, this produces some meaningful findings concerning the validity of the contrasting theories.

4. FINDINGS: CROSS-NATIONAL VARIATIONS IN UNDECLARED EMPLOYMENT IN THE EU-27

To evaluate the prevalence of undeclared employment in the EU-27, firstly, the 26,659 participants surveyed were asked whether they had undertaken wholly undeclared employment in the prior year and secondly, the sub-set of 11,587 participants who were in declared employment were asked whether they had received an additional undeclared envelope wage from their employer in the year prior to the survey. To estimate the level of wholly undeclared employment, those one-off jobs undertaken for close social relations (e.g., kin, friends, neighbours and acquaintances) for reasons related to redistributing money or helping somebody in need have been excluded since these are ‘paid favours’ and more akin to unpaid community exchange than an employment relationship. However, all other forms of wholly undeclared employment are included ranging from permanent full-time undeclared waged employment and self-employment, through to all part-time, temporary or short-term work regardless of its duration, just as is the case when analyzing the level of participation in declared employment.

The finding is that across the EU-27, 90.8% of jobs are declared, meaning that 9.2% of all jobs held by participants in the year prior to the survey was undeclared employment (see table 1). Extrapolating from this, 20.6 million of the 224 million jobs in the EU-27 would be undeclared. Undeclared employment, however, is not evenly distributed across the EU-27. The proportion of jobs that are declared ranges from 99% in Luxembourg, 97% in the UK, 96.9% in Germany and 96.5% in Finland to 81.3% in Poland, 76.2% in Bulgaria, 70.4% in Latvia and 64.3% in Romania. At first sight therefore, there appears to be an East/West regional divide in the EU-27 with East-Central European countries having higher levels of undeclared employment than Western European nations.

To analyze this, table 1 groups member states into four EU regions: Western, East-Central and Southern Europe and the Nordic nations. This reveals not only an East-to-West but also South-to-North divide in the EU-27. In Western Europe, 4.6% of employment is undeclared compared with 20.1% in East-Central Europe, whilst in Nordic nations, 8.4% of employment is undeclared compared with 10.3% in Southern Europe. Employment relations on the Eastern/Southern side are therefore less declared than on the Western/Nordic side, although the East-to-West divide is more marked than the South-to-North divide.
Table 1. Prevalence of, and reasons for, undeclared employment in EU-27

<table>
<thead>
<tr>
<th>Country</th>
<th>% of jobs that are declared</th>
<th>% of undeclared employment driven by:</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>exit</td>
<td>exclusion</td>
<td>both exit and exclusion</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EU-27</td>
<td>90.8</td>
<td>51</td>
<td>46</td>
<td>3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nordic nations</td>
<td>91.6</td>
<td>77</td>
<td>21</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td>96.5</td>
<td>78</td>
<td>22</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>92.1</td>
<td>67</td>
<td>33</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>87.7</td>
<td>93</td>
<td>7</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Western Europe</td>
<td>95.4</td>
<td>71</td>
<td>27</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Luxembourg</td>
<td>99.0</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK</td>
<td>97.0</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>96.9</td>
<td>78</td>
<td>22</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>95.4</td>
<td>56</td>
<td>44</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ireland</td>
<td>93.3</td>
<td>67</td>
<td>33</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td>91.4</td>
<td>65</td>
<td>35</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>90.3</td>
<td>89</td>
<td>8</td>
<td>3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Belgium</td>
<td>88.6</td>
<td>73</td>
<td>23</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>East-Central Europe</td>
<td>79.9</td>
<td>39</td>
<td>56</td>
<td>5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Czech Rep</td>
<td>93.0</td>
<td>58</td>
<td>38</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Slovenia</td>
<td>91.8</td>
<td>75</td>
<td>25</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Slovak Rep</td>
<td>87.0</td>
<td>56</td>
<td>44</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Estonia</td>
<td>82.8</td>
<td>67</td>
<td>33</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hungary</td>
<td>82.7</td>
<td>50</td>
<td>36</td>
<td>14</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lithuania</td>
<td>81.8</td>
<td>53</td>
<td>40</td>
<td>7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poland</td>
<td>81.3</td>
<td>27</td>
<td>66</td>
<td>7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bulgaria</td>
<td>76.2</td>
<td>59</td>
<td>41</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Latvia</td>
<td>70.4</td>
<td>70</td>
<td>30</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Romania</td>
<td>64.3</td>
<td>23</td>
<td>74</td>
<td>3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Southern Europe</td>
<td>89.7</td>
<td>40</td>
<td>56</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Malta</td>
<td>99.0</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cyprus</td>
<td>94.1</td>
<td>50</td>
<td>50</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portugal</td>
<td>91.3</td>
<td>33</td>
<td>67</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spain</td>
<td>90.2</td>
<td>49</td>
<td>46</td>
<td>5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Greece</td>
<td>90.2</td>
<td>53</td>
<td>47</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>88.6</td>
<td>26</td>
<td>70</td>
<td>4</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: 2007 Eurobarometer survey on undeclared work data-set.

Turning to the reasons for working undeclared in the EU-27, and in line with the neo-liberal and structuralist perspectives, the proportion driven by exit and exclusion rationales can be examined. On the one hand, those receiving under-declared salaries (i.e., envelope wages) were asked ‘Were you happy with getting part of your salary without having it declared to the tax or social security authorities or would you have preferred to have your total gross salary declared?’ Those happy with receiving under-declared salaries are delineated as participating in this form of undeclared employment out of choice (i.e., for ‘exit’ rationales), whilst those preferring it to be declared are delineated as doing so due to their lack of choice (i.e., for exclusion rationales).
On the other hand, to examine whether wholly undeclared employment was undertaken for exit or exclusion rationales, the responses to three survey questions are here analyzed:

- did you do this activity because you could not find a regular job?
- did you do this activity because the bureaucracy/red tape to carry out a regular job is too complicated?; and
- did you do this activity because taxes and/or social security contributions are too high?

Those agreeing with (1), but not (2) and (3), are delineated as driven into undeclared employment for exclusion rationales, reflecting the political economy thesis that undeclared workers are necessity-driven due to their exclusion from the formal labour market. Meanwhile, those agreeing with (2) and/or (3), but not (1), are delineated as participating in undeclared employment for exit rationales, thus reflecting the neo-liberal thesis that undeclared workers exit the formal economy due to high taxes and the burdensome regulations. Those agreeing with (1) and either or both of (2) and (3) are delineated as participating for a mixture of both exit and exclusion rationales.

Examining the findings, 51% of those engaged in undeclared employment are driven by ‘exit’ rationales, 46% by ‘exclusion’ rationales and 3% by a combination of the two reasons. However, there are marked cross-national variations in the propensity to cite exclusion and exit rationales. Exit rationales are cited by 100% of those in undeclared jobs in the UK, 93% in Denmark and 89% in the Netherlands, but by just 23% in Romania, 26% in Italy and 27% in Poland. Again therefore, there appears to be an East-to-West and North-to-South divide in the rationales for participation in undeclared employment with the neo-liberal thesis being more applicable in some nations but the political economy thesis in others.

To analyze this, table 1 reports the European regional level results. This reveals that in Western Europe and Nordic nations, 71% and 77% of undeclared jobs are undertaken for exit rationales respectively, but just 39% in East-Central Europe and 40% in Southern Europe. Similarly, in Western Europe and Nordic nations, just 27% and 21% of undeclared jobs respectively are conducted for exclusion rationales but 56% in both East-Central Europe and Southern Europe. There is thus again a clear East-to-West and North-to-South divide. Participants in East-Central Europe and Southern Europe are largely driven by exclusion rationales, and thus the political economy is more applicable, whilst those in Western Europe and Nordic nations are largely driven by exit rationales and thus the neo-liberal thesis is more relevant in these European regions.

Taking the variations in the prevalence of, and reasons for, undeclared employment together therefore, a West-to-East and North-to-South divide is delineated. There is a lower prevalence of undeclared employment that is largely of the exit variety in Western European and Nordic nations, and a greater prevalence
of undeclared employment mostly driven by exclusion rationales in East-Central and Southern European nations. How, in consequence, might these cross-national variations be explained?

5. DISCUSSION: EVALUATING THE COMPETING EXPLANATIONS

5.1. Evaluating the Modernisation Perspective

Examining the modernisation thesis that the prevalence of undeclared employment is smaller in modern developed economies and greater in less developed economies, the relationship between the cross-national variations in the prevalence of undeclared employment and GDP per capita (European Commission, 2011, table 3) can be analyzed. Employing Spearman’s rank correlation coefficient due to the non-parametric nature of the data, table 2 reveals a strong significant relationship between the prevalence of undeclared employment and the levels of GDP per capita. The prevalence of undeclared employment is lower in countries with higher levels of GDP per capita. A significant relationship also exists between countries with higher levels of GDP per capita and the proportion of undeclared workers who do so for exit rationales. The prevalence of undeclared employment and proportion conducted for exclusion rationales decreases as countries become wealthier measured in terms of GDP per capita.

Table 2. Relationship between cross-national variations in the prevalence of, and reasons for undeclared employment and societal characteristics: bivariate analyzes using Spearman’s rank correlation coefficient ($r_s$)

<table>
<thead>
<tr>
<th>Societal characteristic</th>
<th>Prevalence of undeclared employment</th>
<th>Reasons for undeclared employment (% conducted for exit rationales)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Modernisation thesis:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>– GDP per capita</td>
<td>–.633**</td>
<td>.510*</td>
</tr>
<tr>
<td>– Purchasing power standards (PPS)</td>
<td>–.666**</td>
<td>.510*</td>
</tr>
<tr>
<td>– Quality of state bureaucracy</td>
<td>–.663**</td>
<td>.521**</td>
</tr>
<tr>
<td>Neo-liberal thesis:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>– Implicit tax rate on labour income</td>
<td>.042</td>
<td>.062</td>
</tr>
<tr>
<td>– Public sector corruption</td>
<td>–.635**</td>
<td>.614**</td>
</tr>
<tr>
<td>Political economy thesis:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>– State expenditure on labour market measures</td>
<td>–.329</td>
<td>.178</td>
</tr>
<tr>
<td>– Social protection expenditure</td>
<td>–.510**</td>
<td>.368</td>
</tr>
<tr>
<td>– State redistribution via social transfers</td>
<td>–.405**</td>
<td>.452*</td>
</tr>
<tr>
<td>– Income distribution inequality</td>
<td>.418*</td>
<td>–.419*</td>
</tr>
</tbody>
</table>

* Correlation is significant at the 0.05 level. ** Correlation is significant at the 0.01 level.
Source author’s elaboration.
GDP per capita however, does not take into account the differences in costs of living between countries. Using purchasing power standards (PPS) to evaluate this relationship with undeclared employment (Eurostat, 2013a), a strong correlation is identified. The higher the PPS in a country, the lower is the prevalence of undeclared employment and the more likely it is to be conducted for exit rationales.

Turning to the quality of the state bureaucracy, the International Country Risk Guide (ICRG) uses a 0–4 scale to assess the quality of bureaucracy in a nation with 4 indicating that the quality of state bureaucracy is high and 0 that it is low (ICRG, 2013). Member states with high quality state bureaucracy have the strength and expertise to govern without drastic changes in policy or interruptions in government services, a bureaucracy that is autonomous from political pressure and an established mechanism for recruitment and training. Member states with low quality state bureaucracy are those where a change in government is traumatic in terms of policy formulation and day-to-day administrative functions. Examining the relationship between cross-national variations in the quality of the state bureaucracy and cross-national variations in the prevalence of, and reasons for, undeclared employment, a significant relationship is identified. The higher the quality of state bureaucracy, the less prevalent is undeclared employment and the more likely is such work to be conducted for voluntary exit rationales. Consequently, the modernisation thesis is valid that more developed countries with higher levels of GDP per capita, PPS and better quality state bureaucracies are economies where undeclared employment is less prevalent and more likely to be conducted for voluntary exit rationales. Future research might analyze whether these relationships hold when a wider range of countries and global regions are analyzed.

5.2. Evaluating Neo-liberal Theory

From a neo-liberal perspective, high tax rates drive people into undeclared employment. To analyze this, cross-national variations in the average effective tax burden on employed labour in the form of the level of implicit tax rates (ITR) on labour can be analyzed. This aggregates all direct and indirect taxes paid as well as all employees’ and employers’ social contributions levied on employed labour income, and this is then divided by the total compensation paid to employees (Eurostat, 2010). No statistically significant correlation is identified between the cross-national variations in the ITR on labour and the cross-national variations in the prevalence of undeclared employment or the reasons for engaging in undeclared employment (see table 2).

To examine the neo-liberal hypothesis that public sector corruption leads to undeclared employment being more prevalent due to a greater desire to exit the formal economy, Transparency International’s 2007 Corruption Perceptions Index
Explaining Cross-National Variations in the Prevalence (CPI) explores perceptions of public sector corruption and is a composite index drawing on 14 expert opinion surveys (Transparency International, 2013). This index scores countries on a scale from zero to 10, with zero indicating high levels and 10 low levels of perceived public sector corruption. A strong correlation is found between cross-national variations in the level of public sector corruption and cross-national variations in the prevalence of, and reasons for, undeclared employment. The higher is the perceived level of public sector corruption, the greater is the prevalence of undeclared employment. This therefore supports the neo-liberal assertion that undeclared employment is an exit strategy pursued by workers confronted by bribes and corruption when seeking to enter or remain in the declared economy. However, exit rationales decrease in importance as corruption levels increase, suggesting that undeclared employment is not an outcome of voluntary exit as neo-liberals suggest but is more a tactic pursued by employers which they then impose on their undeclared workers.

5.3. Evaluating the Political Economy Perspective

To evaluate the relationship between cross-national variations in the level of state intervention in work and welfare and cross-national variations in the prevalence of, and reasons for, undeclared employment, the first issue examined is whether and how state intervention in the labour market aimed at correcting disequilibria is correlated with undeclared employment. To achieve this, cross-national variations in the proportion of GDP spent by governments on interventions in the labour market are analyzed. This covers both actual disbursements and foregone revenue (reductions in taxes or social contributions normally payable), targeted at groups with difficulties, such as the unemployed, people in jobs but at risk of involuntary job loss, and inactive persons currently not part of the labour force but who would like a job and are disadvantaged in some manner (European Commission, 2011, table 3). In economies which pursue higher levels of expenditure as a proportion of GDP on labour market interventions, the prevalence of undeclared employment is smaller and more likely to be conducted for exit rationales. However, these relationships are not statistically significant.

Turning to welfare expenditure, it is similarly the case that the greater the level of expenditure on social protection (excluding old age benefits) as a proportion of GDP (European Commission, 2011, table 3), the less prevalent is undeclared employment and the more likely it is to be conducted for exit rationales, although this is not a significant relationship. Similarly, the more the state is successful in using direct taxes to reduce the proportion of the population at risk of poverty, the less prevalent is undeclared employment in economies. Examining state redistribution via direct taxes, measured by the decrease in percentage points of poverty (defined as the proportion of the population with an income below 60% of
the national median income) after social transfers (European Commission, 2011, table 3), a statistically significant correlation is found. The greater the reduction in poverty due to state redistribution via direct taxes in a nation, the less prevalent is undeclared employment and the less likely it is to be undertaken for exclusion rationales. This further supports the political economy explanation that greater state intervention in work and welfare arrangements reduces the prevalence of undeclared employment.

The outcome is that a relationship between the level of equality in societies and the prevalence of undeclared employment can be identified. Analyzing the inequalities in the distribution of income (Eurostat, 2013c), measured by evaluating the ratio of total income (by which is meant equivalized disposable income) received by the 20% of the population with the highest income (top quintile) to that received by the 20% of the population with the lowest income (lowest quintile), a significant correlation is identified between the inequalities in the distribution of income and the prevalence of undeclared employment. The more equal the societies in terms of the distribution of income, the less prevalent is undeclared employment and the less likely is undeclared employment to be conducted for exclusion rationales.

6. CONCLUSIONS

This article has evaluated three contrasting explanations for the cross-national variations in the prevalence of, and reasons for, undeclared employment in the European Union, namely the modernisation thesis which views undeclared employment as more prevalent in less developed economies, the neo-liberal thesis which portrays undeclared employment as more prevalent in economies where high taxes, corruption and too much state interference leads workers to choose to exit the formal economy, and the political economy perspective that represents undeclared employment as more prevalent in countries with inadequate state intervention to protect workers which drives workers to engage in undeclared employment due to their exclusion from declared work and state welfare provision.

Analyzing the modernisation thesis, the finding is that wealthier modern economies where GDP per capita, purchasing power standards and the quality of state bureaucracy are higher, undeclared employment is less prevalent and such work is mostly undertaken out of choice. No evidence, however, is found to support the neo-liberal assertion that higher tax rates led to a greater prevalence of undeclared employment. However, greater levels of public sector corruption are strongly correlated with a greater prevalence of undeclared employment. However, greater levels of public sector corruption are strongly correlated with a greater prevalence of undeclared employment, albeit not due to the voluntary exit of workers as suggested by neo-liberals but more due to employers
Explaining Cross-National Variations in the Prevalence exiting the declared economy and then imposing undeclared employment relationships on their employees. Turning to the neo-liberal thesis that greater state intervention in work and welfare provision results in the greater prevalence of undeclared employment, little evidence is found to support this assertion. Instead, the opposite is the case. As the political economy perspective suggests, a significant correlation is identified between greater intervention in welfare provision and undeclared employment. Those nations with higher levels of social protection expenditure, state redistribution via social transfers and greater equality in the distribution of income, have lower levels of undeclared employment and such work is more commonly conducted out of choice.

Nations where undeclared employment is less prevalent and conducted mostly out of choice therefore, are wealthier, more developed, less corrupt and more equal economies where tax rates are higher and there are higher levels of social protection and more effective redistribution via social transfers. The clear theoretical implication therefore, is that no one existing theoretical explanation suffices. Instead, previous theorisations need to be synthesized. Here, therefore, a ‘neo-modernization’ theorisation is proposed which recognizes the validity of the modernisation thesis that GDP per capita, purchasing power standards and the quality of state bureaucracy, the neo-liberal argument that state corruption and the political economy explanation that state intervention in work and welfare provision are all strongly correlated with cross-national variations in the prevalence of, and reasons for, undeclared employment. Indeed, this certainly explains the higher levels of undeclared employment undertaken more for exclusion rationales in Southern and East-Central European countries, which are generally less developed and equal societies with higher rates of public sector corruption and lower levels of labour market intervention, social protection and state redistribution via social transfers compared with Western European and Nordic nations.

These findings also have clear implications for protecting workers in the undeclared economy and tackling undeclared employment. The advocacy by neo-liberals of lower taxes and de-regulation is not correlated with lower levels of undeclared employment. Instead, lower levels of undeclared employment are correlated with the quality of state bureaucracy, lower public sector corruption and higher social protection expenditure, greater use of redistribution via social transfers and more equal societies. Unlike previous literature on tackling undeclared employment that has focused upon whether punitive deterrence measures or more enabling measures that smooth the transition from undeclared to declared work need to be used (OECD, 2012; Williams and Windebank, 1995), this article has thus very tentatively shown that broader societal characteristics around work and welfare arrangements are also correlated and can no longer be ignored.

Several caveats however, are required regarding these findings. Firstly, care is required not to incur the risk of an ecological fallacy, namely deducing the nature
of individuals from inferences for the group to which those individuals belong. Secondly, care is required not to infer causation from the correlations identified. Thirdly, this paper has only conducted bivariate regression analysis. In future studies, multivariate regression analysis is required to determine how important each characteristic is to the outcome whilst controlling for the other characteristics. This will then enable an evaluation of whether each relationship holds as well as which are most strongly correlated with undeclared employment. However, this will still not allow causality to be determined.

In sum, this evaluation of the cross-national variations in the prevalence of, and reasons for, undeclared employment in the EU-27 has resulted in a new theorization that synthesizes different elements of the existing theories. Whether this neo-modernisation thesis remains valid both in the current crisis period, when other global regions are incorporated into the analysis as well as when longitudinal data within individual nations are examined, now needs to be evaluated. If this article encourages such research, as well as recognition and further investigation of the potential need for a wider approach towards improving the work conditions of those in undeclared employment and tackling such work, then it will have achieved its intention.

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